

# Exporting destruction

Export credits, illegal logging and deforestation

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A report by FERN, May 2008

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## List of abbreviations and national export credit agencies

APP	Asia Pulp & Paper
BNDES-Exim	Brazil's export credit agency (Banco Nacional de Desenvolvimento Econômico e Social)
Coface	France's export credit agency
CESCE	Spain's export credit agency
ECA	Export Credit Agency
ECG	Export Credit Group (of the OECD)
ECGD	Export Credit Guarantee Department (UK's export credit agency)
EDC	Export Development Canada
EIA	Environmental Impact Assessment
EKF	Denmark's export credit agency
EKN	Sweden's export credit agency
Euler Hermes	Germany's export credit agency
Finnvera	Finland's export credit agency
IDB	Inter American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
JBIC	Japan Bank for International Cooperation (one of Japan's two export credit agencies)
OECD	Organization for Economic Cooperation and Development
OeKB	Oesterreichische Kontrollbank (Austria's export credit agency)
OPIC	Overseas Private Investment Corporation (one of two US export credit agencies)
NEXI	Nippon Export and Investment Insurance (one of Japan's two export credit agencies)
UFS	United Fiber System
US Ex-Im	US Export Import Bank (one of two US ECAs)

## Executive summary

Exporting Destruction is the conclusion of research that included fieldwork in China, desk studies, and a new financial review, all commissioned to shine a light on the role that export credit agencies (ECAs) play in financing global deforestation. Through detailed case studies and historical research, FERN has been able to produce a set of policy recommendations that would, if implemented effectively, bring export credits in line with other publicly-funded institutions and reduce their potential for negative social and environmental impacts.

The paper suggests that while the primary, if not sole, remit of ECAs is to promote their country's domestic industries in competitive and risky environments, particularly in poor emerging markets, the huge amounts of money involved mean that they also have an important effect on policies and actions in the countries in which they support projects. To put their size in context, ECAs underwrite around US\$100 billion annually in medium and long-term credits and guarantees, compared with, for example, multilateral development banks, which have a combined total of US\$60 billion in loans per year.

ECA involvement in activities that have fuelled unsustainable, and often illegal, deforestation in a number of countries has been documented since the mid 1990s. Evidence in this paper, gathered from community groups around the world, suggests that a number continue to be centrally involved in the sector. Their significance is primarily the result of their 'door opening' public finance status, as well as their focus on countries that are a high-risk for commercial operators, usually those which also lack the institutional governance to regulate their industries effectively.

Direct ECA support for logging or timber trading is minimal because they are not particularly capital-intensive sectors, but significant support from ECAs has been instrumental in aiding the infrastructure and pulp and paper sectors for the last fifteen years, particularly for controversial expansion projects in Indonesia. FERN's report shows that this support was, and continues to be, 'blind', not taking environmental or social issues into account or investigating whether operators' prospectus documents were based on realistic assessments of the nature or ownership of the forest resource.

This lack of 'ground-truth' in assessing projects is shown to be one of the core problems of ECAs. Although taxpayers fund them, their remit is often limited to economic considerations, and they are not currently subject to the binding environmental, social, human rights or transparency standards by which other public sector agencies are governed. The case studies clearly show that this has led to increased illegal logging, corruption and the opening of previously isolated forests. Indeed, experience highlighted in the studies suggest that no ECAs have the relevant procedures in place to identify and address the flawed operating and expansion model that much of the pulp and paper sector has followed.

What's more, by aiming for very low-transaction costs, most ECAs have little internal capacity for assessing the environmental or social impacts of the operations they help to finance.

This report calls on Governments to urgently address the negative impact that ECA-supported operators have internationally, particularly in sensitive sectors such as forestry, and to develop safeguards that would ensure that the operations of export credit agencies do not serve to undermine international commitments to sustainable development and good governance in some of the poorest countries in the world. Such policies should draw on those already in place in most multilateral banks and some of the largest commercial ones, and be resourced and monitored to an extent which ensures diligent implementation.

More specific details on what these policies should look like in the forest sector and how ECAs could be brought into line with two decades of their national governments' commitments to tackle illegal logging and unsustainable deforestation can be found in Chapter 7.

## Chapter I

## A brief overview of ECAs

Export credit agencies and investment insurance agencies, commonly known as ECAs, are public or parastatal institutions that provide government-subsidised loans, guarantees and risk insurance to corporations seeking to do business in countries where the investment climate is judged to be too risky for conventional corporate financing. The policy rationale behind ECAs is to contribute to the economic well-being of the home country by boosting the domestic companies' ability to win major export and construction contracts abroad. In exchange for a premium payment, the exporter will be reimbursed with public money in the event of default. Through a mechanism called 'sovereign counter guarantee' the exporter's government will then seek to recover the loss from the government of the host country.

Most industrialised countries and a growing number of countries with emerging market economies possess an ECA. In 2004, ECAs worldwide supported US\$ 788 billion in trade and investment – some ten percent of the world's total export trade.<sup>1</sup> During the 1990s, financing directly facilitated by ECAs averaged US\$80 to 100 billion per annum, approximately twice the world's total overseas development assistance at the time.<sup>2</sup> In 2004, ECA provision of medium and long-term insurance stood at US\$76 billion – a 16 per cent increase from the US\$66 billion in 2003.<sup>3</sup> ECAs are a very large and important source of finance to the corporate world.

According to the Berne Union, the international union of credit and investment insurers, the trend since 2004 has been to move back towards ECAs funding large scale mining, water, infrastructure, oil and gas projects. Investment in these had reduced since the financial crises in emerging markets that began in 1997.<sup>4</sup> Without ECAs many of these large scale projects in countries in the South would not have gone ahead.

In addition, once companies have ECA backing, they are usually able to leverage even more funding. ECA involvement tends to allow much greater access to sums from the private sector and often functions as the 'door opener' to the international capital market. So while the overall contribution by one or more ECAs to a given project may be small in comparison to other financiers, the project may not have been possible without this crucial public component

1 The Berne Union Yearbook (2006), 24. Available at: <http://www.berneunion.org.uk/>

2 C. Marijnissen, Export Credits: Fuelling illegal logging, FERN, 2002. Available at: [www.fern.org/pubs/briefs/illegal.pdf](http://www.fern.org/pubs/briefs/illegal.pdf)

3 The Berne Union Yearbook (2006), p 17

4 *ibid*, p 25

in the financing consortium. In other words, the importance of ECA funding goes beyond the amount of capital they can bring in.

In addition to direct support for projects, it has been argued that export credit guarantees can actually serve to undermine normal due diligence regimes by banks investing in risky projects. This is because ECA-backing ensures that any potential loss will be recovered by the investor through 'sovereign debt arrangements', reducing the pressure to judge the risk of default accurately. Poor lending by ECAs can therefore lead to an increase in Southern countries' debts. Up to one third of the debt owed by Southern countries has been linked to ECA financing.<sup>5</sup>

ECAs perform different tasks, and work under diverse conditions; they can be private companies acting on behalf of the government or government departments; they differ in their legal and financial status; and to some degree have varying mandates and missions. ECAs often compete with each other to win contracts for their domestic exporters and are thus unlikely to push for unilateral improvements which would put them at a tactical disadvantage. Because of this, recommendations made in this paper would work best if implemented at a regional or international level.



## Chapter II

## ECAs' role in forestry investment

This chapter provides an overview of findings from the case studies that form the backbone of this report. They show how ECAs provide a key source of public financing to large projects in many timber-producing countries currently facing governance problems including the enforcement of laws. Direct ECA support for logging or timber trading is minimal as these are not particularly capital-intensive sectors; however they have provided significant support for the pulp and paper sector and large infrastructure projects during the last fifteen years, particularly to controversial expansion projects in Indonesia. Smaller scale pulp mills are typically financed purely from domestic and international capital markets, however, mills larger than 200,000 tonnes per annum are rarely established without the support of public institutions, either multilateral development banks or ECAs.<sup>6</sup>

Although the operators of these projects may not be directly cutting trees illegally, in many cases they have indirectly contributed to illegal logging by increasing the demand for raw timber to a level which dwarfs the local legal capacity to produce it. Indeed, many of the pulp and paper operations in Indonesia and elsewhere were built on the premise of the availability of illegal sources of timber. Furthermore, the ECAs' 'seal of approval' and export guarantee made it possible to attract significant private sector investment for projects suffering from extraordinarily risky environmental, social, and financial conditions without the commensurate due diligence.

In the Asian pulp and paper sector particularly, European export credits have supported first phase funding for most large greenfield projects and many significant capacity expansions. International Monetary Fund (IMF) data suggests that, in 1996, officially supported export credits accounted for 24 per cent of Indonesia's external debt (US\$ 28.2 billion), having grown by 25 per cent between 1992 and 1996. A recent study shows that the pulp and paper industry was the second largest recipient (and defaulter) of Indonesian export credits after the power sector.<sup>7</sup>

The case studies annexed to this paper highlight how the unsustainable expansion of Indonesia's pulp and paper giant Asia Pulp & Paper (APP), resulted in 'the largest default in emerging market history.' This was made possible by ECAs from the United States, Canada, Japan and six European countries, at least four of which still have loans outstanding from the investment.

6 M. Spek, *Financing Pulp Mills: An appraisal of Risk Assessment and Safeguard Procedures*, CIFOR, December 2005  
7 S. Fried and T. Soentoro, *Export Credit Agency Finance Featuring the Mining Oil and Gas Sectors*, 2002

Despite this, ECAs have recently begun to further underwrite APP's operations, in this case a new expansion into China amidst growing concerns over a looming raw material crisis in the Chinese pulp and paper sector (see Case Study One (page 25)).

It has also been common practice for pulp and paper mills in Indonesia to double their initial production capacity and demand for raw materials within the first years of operating. A major expansion usually happens shortly after mill production is 'on stream' as this allows them easier access to commercial financial markets. This is followed-up with smaller expansions through 'de-bottlenecking' (optimising) production processes.<sup>8</sup> For example, between 1994 and 2002, pulp mill expansions in Asia accounted for a 46 per cent of the total increase in capacity,<sup>9</sup> and project documents for the controversial UFS mill (see Case Study Three (page 29)) indicate that the company plans to double its planned pulp mill's capacity in Satui to process 1.2 million tonnes of pulp per year.<sup>10</sup> While these expansions are not always dependent on ECA backing, they are, by and large, expansions to projects that benefited from ECA start-up investment or guarantees. This level of rapid expansion dramatically increases demand for raw material which it is difficult or impossible to supply legally. This consideration does not appear to be currently considered by ECAs in their initial project screening or operator contracts (see case studies).

There have also been many highly controversial projects to build infrastructure in sensitive forest areas. For example, the Camisea natural gas project (see Case Study Four (page 33)), the first major natural gas development in Peru, is located in one of the world's most ecologically prized rainforest in the remote Lower Urubamba Valley of the Peruvian Amazon, between the Alpurimac Reserve and the Manu National Park. Despite reports of this development increasing illegal logging in areas which were not previously accessible, the project has been and continues to be supported by significant export credits.

8 D. Hausknost, *Der Fall 'United Fibre System (UFS)'. Die Beteiligung von Andritz und der Raiffeisen an der Zerstörung der letzten indonesischen Regenwälder*, Global 2000, Vienna, 2005, p. 44

9 M. Spek, *Financing Pulp Mills*, p. 10

10 E. Jurgens/C. Barr/C. Cossalter, *Brief on the Planned United Fibre System (UFS) Pulp Mill Project for South Kalimantan, Indonesia*, CIFOR, 2005, p. 15

## Chapter III

## ECA regulation within the OECD

Despite being public bodies, ECAs have been slow to develop clear guidelines that show how they are accountable or will deal with environmental or social risk, even in sensitive areas such as forestry. Internationally, ECAs are not subject to any legally enforceable social or environmental standards. Even where specific recommendations have been made, for instance by the World Commission on Dams, application of them has been ad hoc at best.<sup>11</sup>

Within the Organization for Economic Co-operation and Development (OECD), ECAs are governed through the Arrangement on Officially Supported Export Credits, establishing a legal and financial framework for export credit provision. Non-fiscal issues (e.g. environmental matters, measures to deter bribery and the question of competition from non-OECD ECAs) are discussed in the OECD's Export Credit Group (ECG), providing a forum in which to negotiate non-binding common guiding principles, resolve difficulties and improve co-operation between national competitors.

In the last decade most OECD-based ECAs have adopted some policies regarding the environmental and social impacts of their business. As a consequence, Environmental Impact Assessments (EIA) for projects with potentially significant adverse effects are now required, or 'typically required' for all OECD ECAs. In response to civil society and G8 pressure, the ECG undertook to develop its first environmental and social guidelines for ECAs in 1999: the OECD Recommendation on Common Approaches on the Environment and Officially Supported Export Credits (hereafter 'Common Approaches')<sup>12</sup> was finally adopted on a voluntary basis by all OECD ECAs in late 2003. The Common Approaches aim to level the international playing field by identifying and evaluating the environmental and social impacts of ECA-backed projects and government projects supported by export credit guarantees or loans of greater than 10 million SDRs (US\$15.3 million or €11.2 million). The latest revision includes the following recommendations:

- Projects should, in all cases, comply with the environmental standards of the host country. When the relevant international standards against which the project has been judged are more stringent, these standards should be applied.

11 The OECD issued a statement recognising 'the value of the Core Values and Strategic Priorities of the World Commission on Dams' after fierce opposition from civil society to a new OECD initiative granting financial incentives to large dams without additional safeguards against the negative social and environmental impacts. The 2005 OECD Statement on Export Credits and Hydro-power projects is available at : [http://www.oecd.org/document/41/0,2340,en\\_2649\\_34169\\_35688937\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/41/0,2340,en_2649_34169_35688937_1_1_1_1,00.html)

12 Available at: [http://www.oecd.org/olis/2007doc.nsf/linkto/tad-ecg\(2007\)9](http://www.oecd.org/olis/2007doc.nsf/linkto/tad-ecg(2007)9)

- Projects should be screened and classified according to their potential environmental impacts. For category A projects (with the potential to have significant adverse environmental impacts) ECAs should require an Environmental Impact Assessment and make it publicly available thirty calendar days before final commitment to grant project support.
- The relevant international standards to screen projects against are the ten safeguard policies developed by the World Bank or, where appropriate, the International Finance Corporation (IFC) Performance Standards, standards of Regional Development Banks, or of the European Community.

However, it should be noted that the Common Approaches are a non-binding recommendation. Moreover, the recommendation contains a clause (Article 13) that allows member ECAs, "should they so decide" to opt out of applying any standards at all, provided they report and justify this to the ECG on a semi-annual basis but without any requirement that such cases be shared publicly. This derogation clause severely limits the effectiveness of the Common Approaches.

Annex I of the Common Approaches identifies an indicative list of 'Category A' projects (those requiring an EIA) that includes:

- Large-scale logging;
- Industrial plants for the production of pulp, paper and board from timber or similar fibrous materials with a production capacity exceeding 200 air-dried metric tonnes per day;
- Large-scale primary agriculture/sylviculture involving intensification or conversion of natural habitats;
- Projects which are planned to be carried out in sensitive locations or are likely to have a perceptible impact on such locations, even if the project category does not appear in the above list. Such sensitive locations include National Parks and other protected areas identified by national or international law, and other sensitive locations of international, national or regional importance, such as wetlands, forests with high biodiversity value, areas of archaeological or cultural significance, and areas of importance for indigenous peoples or other vulnerable groups.

However, the ECG's annual report from 2004 details three pulp and paper mills as Category B investments (compared with five classified as Category A). No EIA is required for Category B projects and no further information on the projects (e.g. production capacity) has been made public. A public verification of the correct and coherent classification of such projects is virtually impossible and the incorrect classification of some projects as category B by some ECAs (to avoid more comprehensive due diligence) has already been a point of contention among ECAs in the OECD.

Short-term credit options represent another potential gap in due diligence. They are rarely covered by the application of the Common Approaches, as they are invariably identified as Category C (likely to have minimal or no adverse environmental impacts). As Category C projects, they are not subject to voluntary disclosure recommendations, and as such, information about them is limited. Unsubstantiated anecdotal evidence from International Crisis Group representatives identifies Belgian ECA, Ducroire, as providing this sort of flexible financial support for timber exporters operating out of the Democratic Republic of

Congo during its civil war despite the dubious legality of trading in what is known as “conflict timber”.<sup>13</sup>

In June 2007 the OECD issued a revised Recommendation on Common Approaches. The number of World Bank group standards that ECAs are required to benchmark projects against has increased (from four to ten) and minor changes to both prior and after the fact reporting requirements were added to the 2003 version of the Recommendation. However, the retention of the derogation clause (Article 13, see above), allowing members to opt out of applying any standards at all, with no effective peer review and no public justification, renders the Recommendation ineffective. It appears that ECAs still have little ambition to address the environmental and social impacts of their business through international best practice.



## Chapter IV

## ECAs, the forest sector and corruption

Corruption is widely recognised as a key problem underpinning illegal logging in many timber producing countries. NGOs such as Global Witness, are increasingly able to document how corruption plays a facilitating role in the illegal allocation of concessions, movement and export of illegally cut timber and avoidance of judicial action or sanction. Examples of corruption in the forest sector include:

- payment of bribes to government officials and politicians for preferential treatment (for example award of a procurement contract, a timber concession or a subsidy);
- financial extortion by officials from operators to artificially legalise illegal operations (transportation permits, harvesting licences, forest land use conversion);
- official decisions that favour certain groups (for instance when allocating timber concessions), with the tacit understanding that the group will eventually repay the favour;
- timber companies evading national regulations with relative impunity, thanks to the protection of powerful patrons.<sup>14</sup>

The UK Commission for Africa highlighted the role of ECAs in exacerbating the problem of corruption and their 'poor record of using their unique position to encourage better governance',<sup>15</sup> calling for significant improvements of their existing anti-corruption procedures.

In February 1999 an OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed by all EU governments came into force. The Convention is open to accession by non-members of the OECD and created a legal requirement that signatories:

***"take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business."*<sup>16</sup>**

14 FAO, Best Practices for Improving Law Compliances in the Forestry Sector, March 2005, pp15

15 UK Commission for Africa, Our Common Interest, March 2005, pp 153

16 OECD Working Group on Bribery in International Business Transactions, Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, March 1999. Available at: [http://www.oecd.org/document/21/0,3343,fr\\_2649\\_34859\\_2017813\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/21/0,3343,fr_2649_34859_2017813_1_1_1_1,00.html)

In addition, Article 12 of the Convention provides for monitoring and follow-up to promote the full implementation of the Convention, stating ***“The Parties shall co-operate in carrying out a programme of systematic follow-up to monitor and promote the full implementation of this Convention.”***<sup>17</sup>

In December 2000, the ECG responded to this and issued an Action Statement on Bribery, recognizing the important role ECAs play in either tolerating or combating corrupt business practices. However, the 2000 Statement proved too weak to act as a serious deterrent to corrupt business practices and after calls by the Commission for Africa and G8 (issued at the 2005 Gleneagles summit) to strengthen anti-bribery rules for ECAs, an updated Action Statement was adopted in May 2006<sup>18</sup> and converted into an OECD Recommendation in December.<sup>19</sup>

The statement defines the recommended ‘appropriate measures to deter bribery’ as:

- informing exporters requesting support about the legal consequences of bribery under its national legal system;
- requiring exporters to provide a declaration that they have ‘[not] been engaged or will [not] engage in bribery in the transaction’;
- requiring exporters to inform the ECA if they are the subject of charges or past convictions in a national court for bribing a foreign official in a five-year period preceding the application;
- requiring exporters to disclose information on agents’ fees and commissions;
- requiring ECAs to verify whether an applicant appears on any of the debarment lists of the international financial institutions, and in case that it is listed to undertake ‘enhanced due diligence’ before proceeding the application;
- requiring ECAs to suspend approval of any application in the event that there is ‘credible evidence’ of bribery.

It includes the following sanctions:

***“If, before credit, cover or other support has been approved, there is credible evidence that bribery was involved in the award or execution, suspending the approval of the application [...], refuse to approve credit [...] and informing their law enforcement authorities promptly.***

***If, after credit, cover or other support has been approved, and bribery has been proven, taking appropriate action, such as denial of payment, indemnification, or refund of sums provided.”***<sup>20</sup>

<sup>17</sup> *ibid*

<sup>18</sup> OECD Working Party on Export Credits and Credit Guarantees, Action Statement on Bribery and Officially Supported Export Credits, May 2006, available at: [http://www.oilis.oecd.org/oilis/2006doc.nsf/43bb6130e5e86e5fc12569fa005d004c/8921bcae0049ac4ac125716b00355a46/\\$FILE/JT03208704.PDF](http://www.oilis.oecd.org/oilis/2006doc.nsf/43bb6130e5e86e5fc12569fa005d004c/8921bcae0049ac4ac125716b00355a46/$FILE/JT03208704.PDF)

<sup>19</sup> OECD Working Party on Export Credits and Credit Guarantees: Council Recommendation on Bribery and Officially Supported Export Credits, December 2006, available at: [http://webdomino1.oecd.org/oilis/2006doc.nsf/43bb6130e5e86e5fc12569fa005d004c/25bedfd6d02050d2c1257248005cd463/\\$FILE/JT03219827.PDF](http://webdomino1.oecd.org/oilis/2006doc.nsf/43bb6130e5e86e5fc12569fa005d004c/25bedfd6d02050d2c1257248005cd463/$FILE/JT03219827.PDF)

<sup>20</sup> *ibid*

The Action Statement does not require ECAs to debar companies that have been convicted for foreign bribery offences, even in cases where those companies have been debarred by the World Bank or other international financial institutions. No peer review mechanism has been developed for monitoring company undertakings and no processes are in place for the investigation of local or international NGO allegations of corruption.

The Statement is supported by a rather feeble set of penalties, which are discretionary and inadequately defined. Tellingly there have been no cases brought to date.

## Chapter V

## ECAs, the forest sector and transparency

The level of publicly available information relating to specific investments supported by ECAs varies widely in practice and overall lags behind disclosure policies of other public institutions.

Some commentators have suggested that the recent adoption of an EU Directive on Public Access to Environmental Information<sup>21</sup> could be about to change this, for European Member State ECAs at least.<sup>22</sup> The Directive places legally binding requirements on all public authorities to share environmental data with the public, in line with previous commitments to the Aarhus Convention.<sup>23</sup> However, the Directive protects information that may compromise national safety, international relations and the confidentiality of commercial or industrial information or intellectual property rights; the latter argument being frequently used against increased information disclosure on behalf of ECA clients.

A recent test request for the ex-post release of information about the discretionary application of recommended standards to Category A and B projects under this Directive was refused by the UK's ECGD on the grounds that:

***“The requested information is subject to Exception 12(5)(a) – International Relations of the EIRs and therefore cannot be disclosed. The release of the requested document would be prejudicial to the effective conduct of the UK’s international relations in that its disclosure would unacceptably damage the UK’s interest in the mutual sharing of information between export credit agencies, and undermine the mutual confidence serving to buttress the OECD Consensus. Public disclosure of the requested document was not envisaged by the contributing countries and disclosure would inhibit the level of openness and free and frank exchange of information vital to the effective implementation of the Common Approaches of the OECD Working Party on Export***

21 Directive 2003/4/EC of the European Parliament and of the Council of 28 January 2003 on public access to environmental information available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0004:EN:HTML>

22 Judith Neyer, Blood From a Stone: Can the new EU Directive on access to information force ECAs to open up? FERN, November 2004. Available at: <http://www.fern.org/pubs/briefs/Aarhus%20Oct%2004.pdf>

23 The UNECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters grants the public rights and imposes on Parties and public authorities obligations regarding access to information and public participation and access to justice. The Convention was adopted in Aarhus, Denmark in 1998 and at the time of writing 40 countries have ratified. See: <http://www.unece.org/env/pp/>

***Credits and the functioning of this organisation. The UK's relationship with other countries and an international organisation would be adversely affected.*<sup>24</sup>**

Improved transparency is a key opportunity for improving the quality and impacts of ECA supported projects in the forest sector and beyond. Timely public disclosure of both proposed project documents and of the revenues of operations in countries that suffer from poor governance and illegal logging are likely to lead to more sensitive investment decisions, deter bribery and support improved governance in forest departments and central governments (see *Export credits, the forest sector and corruption*, above).

Unfortunately, the disclosure requirements placed on ECAs through the OECD's Common Approaches (see above) are non-binding, and compliance has been uneven (see *Export credits, the forest sector and corruption*, above).

To ensure more responsible and equitable management of extractive industries, many international financial institutions (IFIs) have started to endorse the principle of (conditional) contract and revenue transparency. This is not currently under serious consideration by the ECG despite there being a strong business and development case for it, set out in the Extractive Industries Transparency Initiative (EITI) Guidelines.<sup>25</sup> Some recommendations of the EITI have been formally endorsed by the International Monetary Fund (IMF), the European Bank for Reconstruction and Development, the IFC and World Bank Group, the G8 heads of State, the Commission for Africa and, as the only ECA since September 2006, the U.S. Overseas Private Investment Corporation (OPIC).<sup>26</sup>

The IFC requires in its Sustainability policy (para 22) not only public transparency of revenue payments from extractive industry projects to host governments, but also the public release of relevant terms of public concern in foreign investment contracts, such as Host Government Agreements (HGA) and intergovernmental agreements. The IMF also supports disclosure of foreign investment contracts, while addressing concerns about the disclosure of confidential business information, stating, "the contract terms are likely to be known within the industry soon after signing. Little by way of strategic advantage thus seems to be lost through publication of contracts."<sup>27</sup>

These recommendations are specific to the extractive industries, but many similar governance challenges are endemic to the forestry sector.

<sup>24</sup> Letter from Paul Redmond, Information Officer, ECGD to Nicholas Hildyard, The Corner House, January 2006

<sup>25</sup> Available at: <http://www2.dfid.gov.uk/pubs/files/eitidraftreportstatement.pdf>

<sup>26</sup> OPIC now also commits to make public the standard environmental and social covenants used in Category A Projects, Environmental Management and Monitoring Plans, and Environmental Remediation Plans.

<sup>27</sup> International Monetary Fund: Guide on Resource Revenue Transparency, June 2005. Available at: <http://www.imf.org/external/pubs/ft/grrt/eng/060705.htm>



## Chapter VI

## The key challenges facing ECAs

ECAs' mandate and institutional set-up are both the source of many of the problems this paper highlights, and the primary difficulty involved in solving them. This chapter highlights each of the issues that are at the heart of ECA's failure to ensure that their activities are in line with the sustainable development commitments of their national governments, and discusses ways in which they can be remedied.

### Lack of accountability

Responsible export credit provision is often undermined by a lack of effective accountability policies or mechanisms on the part of both the ECA and the companies they support.

While export credits for greenfield pulp and paper and infrastructure projects are considered by many to be a catalyst for additional commercial investment, a single ECA is almost never responsible for the total investment required to establish such a project. This makes it hard for any single ECA to be held accountable for the impacts of a project supported by an investment consortium. ECAs also claim that they are, by definition, largely reactive, demand-driven institutions typically entering at the 'tail end' of the deal process, after project plans are largely finalised. If this is the case, then ECAs have limited leeway to seek out socially and environmentally preferable investments.<sup>28</sup> However, it is unreasonable to expect a publicly-funded, in some cases, fully public body, to operate without clear accountability mechanisms relating to the impacts of their work. This is even more pertinent since commercial banks, on the other hand, seem to rely largely on ECAs to carry out their social and environmental due diligence for them: As one representative of a large German bank recently told a pulp and paper critic, once a proposed project has secured a German export guarantee, the banks will fund it without much further analysis on their part.<sup>29</sup>

The lack of monitoring or auditing requirements in standard ECA contracts undermines attempts to ensure that projects meet the financial or environmental projections established during the due diligence and EIA processes. Both the IFC and the World Bank's Multilateral Investment Guarantee Agency (MIGA) have contract clauses requiring early repayment of

<sup>28</sup> J. Harmon/C. Maurer/J. Sohn /T. Carbonell: *Diverging Paths. What Future for Export Credit Agencies in Development Finance?* World Resources Institute, 2005

<sup>29</sup> 'Pulp Friction' New Internationalist Radio Interview with Chris Lang, 09.09.2007. Available at <http://www.newint.org/radio/> (last accessed on 04.10.2007)

loans if safeguard requirements are not met. This is particularly pertinent given the trend towards significant expansion shortly after a pulp and paper project has begun operating. The debt-restructuring deal reached between APP and ECAs in April 2005 was widely considered generous, despite APP being in the midst of another US\$ 3.1 billion expansion in China; facing serious concerns over raw material supplies and allegations of illegal logging and corruption; and having overall poor corporate and financial governance (see case study I on page 25). This suggests that ECAs are still not taking the opportunity to call for operational improvements where possible, and poor performance is not currently considered by ECAs a reason to penalise those who have benefited from export credits.

There appears to be a tendency to allocate the role of 'conscience' to NGOs rather than to develop effective, binding screening/conditionality procedures that would allow ECAs to make responsible decisions about project support.

As with commercial banks, export credit agency transaction costs are expected to be minimal and resources are restricted. If issues outside ECAs' historical remit are to be considered then it will be necessary for their staff to be better trained and resourced.

### **Lack of coherence between trade promotion policies and the sustainable development agenda**

ECAs have a primary, and occasionally single, mandate to facilitate exports and overseas investments by national business. The oldest ECA, the UK's Export Credit Guarantee Department, derives its powers from the 1919 Export and Investment Guarantees Act,<sup>30</sup> which sets out the responsibilities relating to supporting the export of goods and services and insuring investment, in addition to financial management within the department. There is no reference to any impacts of this investment aside from the potential growth in the UK economy. Similarly, the OECD Common Approaches preamble includes the following statement:

***'Recognising that while Members may have different means of delivering official support for export credits through their export credit agencies (ECAs), the primary role of ECAs is to promote trade in a competitive environment, whereas multilateral development banks and development agencies focus primarily on development assistance.'*<sup>31</sup>**

The majority of OECD governments are committed to international development objectives such as the Millennium Development Goals, particularly those related to governance issues such as corruption and revenue transparency. There is clearly an opportunity for improved coherence and co-ordination between the different arms of government on critical issues such as governance (including forest governance) in developing countries. This will ensure that projects funded by governments through ECAs adhere to the same rules governing corruption, accountability and transparency.

<sup>30</sup> See: [www.hms.gov.uk/acts/acts1991/Ukpga\\_19910067\\_en\\_2.htm#mdiv1](http://www.hms.gov.uk/acts/acts1991/Ukpga_19910067_en_2.htm#mdiv1)

<sup>31</sup> OECD Export Credit Working Group, Recommendation on Common Approaches on Environment and Officially Supported Export Credits, pp 1

### Competition from emerging ECAs and the importance of international standards

As with the private-sector investors and insurers that they support, ECAs are facing growing international competition. Budding ECAs from emerging countries, particularly China and Brazil, have started to challenge their established rivals in the OECD club.<sup>32</sup> Western ECAs argue that this potentially causes competitive disadvantages for them because these new agencies have not committed to international standards on governance or the environment. China, in particular, has been accused of securing projects for its companies overseas by undercutting the environmental, labour and human rights standards imposed by western institutions.<sup>33</sup>

A number of projects and processes seem to support this concern,<sup>34</sup> particularly in the African forest sector where Chinese buyers have been criticised for buying increasing quantities of illegal logs. According to Global Timber, a UK-based website, 80-100 per cent of China's timber imports from Cameroon, Congo Brazzaville, Equatorial Guinea and Gabon are illegal.<sup>35</sup> It must be noted, however, that most of those imports, are re-exported as processed goods onto the world's markets.

China's ECA, the China Export-Import Bank, established in 1994 is today one of, if not the largest ECA and *the* most important financier of African infrastructure projects. If current growth continues it will be issuing over US\$40 billion in loans and guarantees annually by 2010, making it the largest state-supported international financial institution.<sup>36</sup> Chinese trade with Africa, alone, was worth nearly US\$40 billion last year, and is rising fast. China already imports 30 per cent of its oil from Africa, mainly from Sudan, Angola and Congo-Brazzaville, and 'when conditions are ripe,' is looking to negotiate a free-trade agreement with the continent.<sup>37</sup> It is expected that such an agreement would cover a wide range of natural resources including timber, Chinese imports of which were valued at US\$17.627 billion in 2005.<sup>38</sup>

The human rights and environmental track record of some of the newcomers' governments and the fact that ever scarcer resources are pushing countries like China into the margins of exploration in more politically, socially or environmentally vulnerable areas, highlights the importance of developing a binding, international framework for the provision of export credits and guarantees.

Contrary to the claims of many western ECAs, such a process would not have to start from scratch. Some extra-OECD agencies have endorsed the Common Approaches and some

32 Scandinavian ECAs in particular (Finnvera, EKN, and SEK) have noted increase competition from China in financing Asian pulp and paper mills, citing the UFS case-study as a case in point. Scandinavian ECAs had not been consulted about participating in the financing of the project, despite the supply of machinery from European engineering firms. See: Feeding China's Growing Demand for Wood Pulp: CIFOR Workshop Report, March 2004. Available at: [http://www.cifor.cgiar.org/publications/pdf\\_files/research/governance/foresttrade/Attachment50-Europe\\_Consultative\\_wshop\\_Brussels\\_24Mar04.pdf](http://www.cifor.cgiar.org/publications/pdf_files/research/governance/foresttrade/Attachment50-Europe_Consultative_wshop_Brussels_24Mar04.pdf)

33 Philippe Maystadt, President of the European Investment Bank, claimed in a recent interview that Chinese banks had snatched projects from under his bank's nose in Africa by undercutting the EIB's labour and environmental standards: "... the competition with Chinese banks is obvious. We are talking about institutions that do not pay any attention to the environmental and social standards of projects, as we would do." Financial Times, EIB accuses China of unscrupulous loans, 28 November 2006

34 For example, in 2003, the Sudanese government sought and received financial support from China Exim Bank (\$520 million) for the Merowe Dam, a large hydropower project for which Western export credit agencies declined support because of its likely social and environmental impacts.

35 <http://www.globaltimber.org.uk/ChinaIllegalImpExp.htm>

36 For more information about China's export credit agency see: P. Bosshard, China's Role in Financing African Infrastructure, IRN, May 2007

37 No Questions Asked: Human Rights No Bar to China's Hunt for Resources, The Economist 19 January 2006

38 Favourable Balance of Forest Products Trade in 2005, China.org.cn, 22 February 2006

ambitious developing country banks are declaring they have more rigorous screening criteria than international standards call for.<sup>39</sup> China Exim Bank adopted its own environmental policy in November 2004 and released it to the public in April 2007. The policy stipulates the review of environmental impacts before, during and after project implementation. China Exim Bank also does not cite any financial threshold in its policy, potentially allowing for a broader scope of environmental screening.<sup>40</sup> While China Exim's environmental policy offers little guidance as to its practical implementation, the *principles* it espouses are stricter than the OECD recommendation on export credits and the environment in that they cover more than mere ex-ante assessment of expected impacts.

China declared that it is not prepared to accept obligations regarding export credits that the OECD, of which it is not a member, has developed. But it has expressed an interest in training and joint projects with World Bank institutions to learn more about the implementation of international environmental standards.<sup>41</sup>

A level international playing field, established jointly with non-OECD countries in a truly international forum may therefore be the most effective way to manage the negative impacts of investment supported by governments through export credits. However, for this to happen, OECD countries need to lead by example. A coherent and stringent application of existing OECD environmental and social standards, including those international environmental agreements and conventions to which OECD members subscribe, must be the first step in this process.

39 For example Banco Itau in Brazil, besides adhering to the Equator Principle requirements, explicitly declares that it goes beyond the Principles in extending screening to all projects valued at 5 million Reales (about \$2.6 million) or more.

40 "China Exim Bank is paying high-level of attention to our funded projects' environmental impacts. We enhance environmental monitoring and management before, during and after the project implementation." For a comprehensive assessment of China Exim's environmental policy see: International Rivers Network/Environmental Defense, <http://www.internationalrivers.org/en/node/1677>. Available at: <http://www.irn.org/pdf/finance/070916exim.pdf>

41 *ibid*

## Chapter VII

# Recommendations

In order for ECAs to stop causing harm and fulfil the full range of their responsibilities as Government agencies, the following actions must be taken at the national, regional and international level:

### ECAs involved in forest sector investment

- Develop adequate in-house capacity to critically assess the quality of Environmental Impact Assessments as well as additional documentation, analysis and assessments supplied by clients.
- Require any company seeking support to provide credible and independent analysis demonstrating the availability of legal and sustainable wood sources for all raw material. This should include independent information on land conflicts affecting that supply, assumptions about annual growth rates, and expected impacts on natural forests; to be received and approved before an agreement is made to finance a pulp and paper project.
- Critically assess the track-record of project operators and companies seeking cover for investments, with a view to refusing support for companies which operate illegally or contravene national or international commitments to forest protection and indigenous rights. Such analysis should also evaluate previous compliance against applicable legal norms regarding financial management.

### ECAs in the OECD's Export Credit Group

- Adopt binding transparency policies that ensure the timely public disclosure of proposed project documents (including all legislation, rules and regulations, concession maps and concession details) and of revenue from forest-related development projects.
- Adopt and implement significantly strengthened anti-bribery policies and measures to act as an effective deterrent to corrupt business practices in the forest sector as part of the ongoing review of OECD's instruments in combating bribery in international business transactions.
- Create an exclusion list including projects:
  - operating in or in immediate proximity of National Parks and other protected areas identified by national or international law;
  - in High Conservation Value Forests (including wetlands, forests with high biodiversity value, areas of archaeological or cultural significance, and areas of importance for indigenous peoples or other vulnerable groups);



- on disputed lands or where companies that have been convicted of illegal logging, are in the midst of unresolved land right conflicts, or where it cannot be proved that indigenous peoples have been granted their right to free prior informed consent.
- that aim to convert forests to palm oil projects (is in line with Roundtable on Sustainable Palm Oil (RSPO)).
- Ensure that their policies are developed in partnership with members of the private sector, national and international civil society groups and those representing communities from affected areas.
- Enter into a dialogue with non-OECD countries with a view to establishing an international level playing field on all of the above issues.

### **Governments of EU Member States**

- Develop specific definitions of ECA due diligence to ensure they have environmental and social screening procedures in place that guarantee projects will not lead to illegal forest sector activity (this is in line with the recommendations of the EU Forest Law Enforcement Governance and Trade (FLEGT) Action Plan).
- Identify ways to request ECAs and other public lending bodies to obtain better information about forest sector investments and the associated risks (as recommended by the EU Forest Law Enforcement Governance and Trade (FLEGT) Action Plan.)
- Develop a proposal for legislative instruments for gathering data on the impact ECAs' forest sector investments are having on climate change. (This is in line with demands of the 2007 European Parliament Resolution on Trade and Climate Change (2007/2003(INI)).

## Case Study I

## Asia Pulp &amp; Paper

## Indonesia: Accountability and debt restructuring

## APP Indonesia

Although its headquarters are in Singapore, Asia Pulp & Paper (APP) is the holding company for the pulp and paper interests of Sinar Mas, one of Indonesia's largest business groups. Since the early 1980s, APP has developed its pulp and paper production capacity in Indonesia and is now expanding into paper and board production in China (see case study II on page 27) and, allegedly, for fiber sourcing, Cambodia.

APP Indonesia accounts for 2.3 million tons of pulp per year and is one of the ten largest producers worldwide. The company led Indonesia's pulp and paper boom that commenced in the 1980s and has been centrally implicated in the largely illegal deforestation of 60 percent of Sumatra's tropical lowland forest between 1990 and 2002.<sup>42</sup> APP's boom was built on the availability of illegal wood obtained from clear-cutting natural forests<sup>43</sup> and mills in Sumatra currently continue to draw roughly 70 percent of their raw material from mixed tropical hardwood harvested from natural forests.<sup>44</sup> It is estimated that a significant proportion of this is logged illegally, much of it in national parks and protected areas.<sup>45</sup>

## The Indah Kiat project

APP/Sinar Mas owns and operates one of Indonesia's largest pulp and paper plants, Indah Kiat in Riau Province, Sumatra, with an annual production capacity of 2 million tonnes of pulp and 700,000 tonnes of paper.<sup>46</sup> For years, the mill had been subject to allegations of illegal logging and sourcing and in 1993 was fined US\$1.4 million for the use of illegal timber.<sup>47</sup>

## ECA support

The massive expansion of the Indonesian pulp and paper industry (a nine-fold increase



**Demonstration against German ECA support for unsustainable pulp mills in Indonesia**

Photo: Barabara Happe/urgewald

between 1988 and 1999) was made possible by international investment of more than US\$15 billion during the 1990s.<sup>48</sup> ECAs contributed significantly to this unsustainable expansion by reducing commercial banks' exposure and undermining the requirement for effective financial diligence or impact assessments.<sup>49</sup> Specifically, ECAs from Austria,

42 E. Jurgens/C. Barr/C. Cossalter, Brief on UFS, p. 3

43 Between 1988 and 1999 this accounts for 92 per cent of the raw material. See E. Matthew/J.W. Van Gelder, Paper Tiger, Hidden Dragons. The responsibility of international financial institutions for Indonesian forest destruction, social conflict and the financial crisis of Asia Pulp & Paper, Friends of the Earth England, May 2001, p. 4

44 E. Jurgens/C. Barr/C. Cossalter, Brief on UFS, p. 17

45 World Bank, Indonesia: Environment and Natural Resource Management in a Time of Transition, Washington D.C. 2001

46 J. Wieting, Clearcut Paper. APP, APRIL and the End of the Rainforest in Sumatra's Riau Province, Results of ROBIN WOOD Research, July 2004

47 R. Carrere and L. Lohmann, Pulping the South. Industrial Tree Plantations and the World Paper Economy, London, 1996, p. 220

48 E. Matthew/J.W. Van Gelder, Paper Tiger, Hidden Dragons, p. 4

49 ibid, p. 5. See also: S. Fried/T. Soentoro, Export Credit Finance in Indonesia, Environmental Defense and Bioforum, December 2000

Canada, Denmark, Finland, Germany, Japan, Spain, Sweden and the US financed the expansion of Indah Kiat's pulp and paper capacity by guaranteeing export credits and extending loans. After the default and



**Pollution from pulp mill in Indonesia**

Photo:Barabara Happe/urgewald

debt standstill of APP in 2001, commercial banks forced the ECAs to take over their outstanding debt. As a consequence, many ECAs still have loans outstanding from APP's Indonesian operations including ECAs from Austria, Canada, Finland, Germany, Italy, Japan, Sweden, and the US; and further undisclosed outstanding loans are likely for ECAs from Denmark and Spain.<sup>50</sup>

### **Debt restructuring and continued expansion**

In 2001, global paper prices dropped significantly and APP infamously collapsed when it was unable to pay its US\$13.9 billion debt. This remains the largest ever default by a single company in an emerging country.<sup>51</sup> Despite this, a number of factors including the company's importance to

the Indonesian national economy and the political connections of its owners, meant that APP managed to strike a favourable debt restructuring deal.<sup>52</sup> As detailed above, international ECAs were, and remain, significant APP creditors and they reportedly played an important role in the debt restructuring process. Under the deal that emerged in April 2005, APP's Indonesian subsidiaries will repay the greater part of their debts within 13 years, while the remainder will be repaid in 18 to 22 years. Local civil society as well as the World Bank called for such a deal to be conditional upon a downsizing and restructuring of the sector and the legal verification of raw supplies, but these requirements were not included.

Seven years after its collapse, and only three years after the debt restructuring deal was signed, APP is currently in the midst of a US\$3.1 billion expansion program in China, with some of the same ECAs that paid for the earlier expansion supporting the export of new machinery from Europe. The Sinar Mas Group aims to increase its global paper and board production capacity to reach 10 million tonnes per year by 2010 and most of this new capacity will be built in China.<sup>53</sup> According to the project literature, raw material will come from plantations, but concerns have been raised by NGOs and forest analysts that there are insufficient plantation stocks to match aimed for levels of productivity which would lead to a significant gap in legal fibre supply in the region. This concern does not appear to have been considered by the European ECAs supporting this sector.

50 Jan Willem van Gelder, Export credits and illegal logging. Data prepared for Chatham House and FERN, Profundo, January 2006, updated March 2008

51 Asia's Worst Deal, Michael Shari, Business Week, New York, 13 August 2001

52 E. Jurgens/C. Barr/C. Cossalter, Brief on the Planned UFS Pulp Mill Project

53 Nie Xiaorong, A glimpse of the future in China. Two new APP mills. Solutions – for People, Processes and Paper, April 2005

## Case Study II

## Jinhai pulp and paper plant in Hainan province, China

### Overcapacity and unsecured fibre sourcing

#### The project

The Hainan Jinhai Pulp & Paper plant on Hainan Island started production in November 2004. The joint venture between APP and the Hainan Forestry General Corporation is the world's largest single-line pulp facility with a capacity of over one million tonnes per year of bleached hardwood kraft (BHK) pulp. With current average production rates of 3,200 tonnes per day the plant swallows around a truckload (30 cubic meters) of wood chips a minute.<sup>54</sup> Roughly one third of the mill's output is sold on the domestic market, with the remaining 70 percent being channelled to APP's other paper and board mills in China.<sup>55</sup>

The Austrian company *Andritz* supplied the wood-processing and pulp-drying facilities and Swedish company *Kvaerner Pulping* the complete fibre line. Other foreign suppliers to the mill are Kvaerner Power, ABB, Siemens, Andritz, Foster Wheeler, BTG, Veolia Water, FL Schmidt, Rexroth, Hagglands, Sulzer Pumps and Aker Kvaerner Chemetics.<sup>56</sup> Total investments in the project amounted to 10.2 billion renminbi (US\$1.3 billion).<sup>57</sup>

In 2006 Hainan Jinhai announced it aims to boost the plant's pulp capacity from 1 million to 1.78 million tonnes per year and build up a fine paper and tissue capacity of almost 2 million tonnes per year to make the mill an integrated facility in the next few years. The cost of the investments will total 13.6 billion renminbi (US\$ 1.8 billion). Two fine paper machines are ordered from Voith Paper (Germany) and six tissue paper machines were ordered from A. Celli (Italy).<sup>58</sup>

#### ECA support

In 2004, *Euler Hermes* (Germany) issued an export credit guarantee to the German



**Outside the Jinhai Pulp & Paper Plant. A truck waiting to sell its timber from natural forests to the Jinhai plant.**

Photo: ZHONG Yu /Greenpeace

company Voith Paper for the sale of a paper machine to APP's Gold East Paper mill, apparently having learnt nothing from the debacle of its involvement with APP in Indonesia's operations (see above).<sup>59</sup> The Gold East mill in Jiangsu province is likely to be supplied by Hainan as they are relatively close and under the same management.

54 The Experiences of the world's biggest Recovery Boiler in Yang Pu at Hainan Jinhai Pulp & Paper Co., K. Haaga/ M. Laitinen, Kvaerner Power Oy, Presentation at the 7th International Colloquium on Black Liquor Combustion and Gasification, University of Jyväskylä, July 31-August 2, 2006

55 Brussels, 4 October 2005, paperloop.com

56 G. Rodden, *The Birth Of A Giant*, PPI, April 2006

57 Jinhai Pulp and Paper Plant Put into Operation formally, SinoCast, Hainan, 31 March 2005; Website APP China (en.app.com.cn), Viewed in March 2008

58 APP China Plans Huge Investment At Hainan, PPI, June 2007

59 China Gold East Paper To Invest \$500 Mln in Paper Making Line, Chinese News Digest, Beijing, 13 April 2004; Übersicht über die endgültig angenommenen Geschäfte 2004, Euler Hermes, Frankfurt, February 2005

In May 2006 Euler Hermes again issued an export credit guarantee to the German company Voith Paper for the supply of a paper machine to China, probably to the Hainan Jinhai plant.<sup>60</sup> The Export Import Bank of the United States approved an export credit guarantee in 1996 for Ningbo Zhonghua Paper, a paperboard mill in Jiangsu province that doubled production capacity to 1.2 million tonnes per year.<sup>61</sup> With every additional pulp and paper mill in the same region, the pressure on natural forests in the area will naturally increase. ECAs seem to be supporting APP's expansion into China without learning lessons from Indonesia.<sup>62</sup>

### Fibre supplies and allegations of illegality

The Hainan mill does not have a secure purchasing policy for its raw material. APP China started investing in Hainan Island's increasing plantation capacity as early as 1997, however, there have been severe raw material shortages at the Jinhai plant since it started operating. APP China has been granted concessions totalling 233,333 ha but only 6,667 ha of eucalyptus plantations appear to have been established, rather than the 64,667 hectares the company claims.<sup>63</sup> Shortly after the mill began operating, local civil society began to gather evidence suggesting that illegal logging was on the increase in Hainan's natural forests. Both domestic environmental groups and the Chinese media have repeatedly accused APP of engaging in illegal activities in Hainan province to overcome the shortage of woodchips required for the mill to operate at its optimal level. While a Greenpeace investigation in 2005 did

not directly attribute illegal logging in the area to APP China's subsidiary Jinhua Forestry Company, there is evidence that land cleared illegally has ended up being used for APP's pulp plantations.

The Hainan plant requires 12,000 tonnes of timber per day. However, during the six months prior to the mill going officially on stream, only one million tonnes of chip stocks had been built up, meaning the mill could only be sustained for three months.<sup>64</sup> In the light of this, APP opened negotiations with local individual and community landowners to attempt to acquire further timber stocks and plantation land. Anecdotal evidence suggests that these negotiations have not yet resulted in secure supplies. In the meantime it appears that APP has resorted to a range of other questionable if not outright illegal efforts to bridge Jinhai's supply gap. A 2002 government policy designed to return land to forests is being used to clear natural forest for pulp plantations. In August 2003 around a hundred people were caught clearing forests in a National Park. They had been hired by APP to make way for pulp trees. This was approved by the provincial government and disguised under the 'returning land to forest' programme. This is not an isolated case: The Hainan Forestry Bureau found that 60 percent of the area allocated for reforestation had been planted with fast growing pulp plantations.<sup>65</sup> Greenpeace China and national newspapers further reported that the Hainan provincial government has started implementing plans to cut down the forests that line the Island's 20,000 km of main roads. The roadside forests, intended to protect the roadbed from wind and water erosion, will be replaced with fast-growing eucalyptus, which will be harvested after 4 to 6 years for the Hainan pulp mill. The provincial government is hoping to provide another

60 Website AuslandsGeschäftsAbsicherung der Bundesrepublik Deutschland ([www.agaportal.de](http://www.agaportal.de)), Viewed in March 2008

61 Meeting Of The Board Of Directors - Summary Of Minutes, Export-Import Bank Of The United States, Washington, 10 September 1996

62 For most recent reports on continuing destructive activities by APP see: Eyes on the Forest to Asia Pulp and Paper, investigative report, Eyes on the Forest, March 2008

63 Greenpeace China, The investigative report into Asia Pulp and Paper (APP) in South China's Hainan Province, May 2005

64 *ibid*, p. 2

65 *ibid*, p.4



26,666 ha plantation land to APP by clearing the windbreaks.<sup>66</sup> In a 2007 investigation, Greenpeace China further found that during the last two years, APP illegally clear-cut several hundred hectares of natural forest inside Hainan's Wuzhishan Natural Reserve<sup>67</sup> and a large area of forest in the Yinggeling Natural Reserve<sup>68</sup> and replaced it with monoculture eucalyptus plantations.

APP China denies accusations that its Jinhai plant suffers from a shortage of woodchips and that it has cut down natural forests to channel to the mill. However, APP also denied other Greenpeace China reports into illegal logging by APP in Yunnan province which were later confirmed by official State Forestry Administration investigations. As the province's Forest Bureau points out, in Hainan '*pulp forests are synonymous with APP's forests.*'<sup>69</sup>

There is also evidence that China's expanding demand for raw materials will also put pressure on timber capacity outside of China. A recent CIFOR assessment of pulp industry expansion and fibre demand in Southern China concludes that adequate Chinese plantations will not be available in the short or mid-term, meaning that Southern China will remain largely reliant on imported wood chips beyond 2009. The paper warns '*There might be strong temptation, on the part of certain players, to fulfill their fibre gap from non-sustainable sources, from countries with governance problems.*'<sup>70</sup> The bulk of this wood is likely to be imported from Indonesia, where APP and its subsidiary Sinar Mas is the largest

national pulp producer; and Cambodia, where an alleged APP subsidiary was found to have illegally felled thousands of cubic meters of timber in the country's Botum Sakor National Park in 2005.<sup>71</sup> The Hainan Jinhai plant also imports wood chips from Australia and Vietnam.<sup>72</sup>

66 Singapore, 11 April 2005, paperloop.com

67 Liu Bing, APP China, Greenpeace China, May 2007

68 Paper Giant APP Accused of Illegal China Logging, Reuters News Service, 29 March 2007

Soon after the Greenpeace allegations, the illegal logging in Yinggeling Natural Reserve has been confirmed by the State Forestry Administration.

69 Greenpeace China: Investigative report into APP, May 2005

70 C. Cossalter, Pulp Industry Expansion and New Wood Fibre Demand in Southern China. Implications for the Region, presentation at the Conference on Future of Forests in East Asia and China, Kuala Lumpur, CIFOR, October 2004

71 APP faces illegal logging allegations in China, Cambodia, Dow Jones Newswire, Jakarta 3 February 2005

72 APP China Plans Huge Investment At Hainan, PPI, June 2007

## Case Study III

**United Fiber System****Indonesia: Corruption and misestimation**

United Fiber System Ltd. (UFS) is a Singapore-listed former construction company without any previous experience in pulp and paper production. It is majority owned by a group of Swedish businessmen and in a recent, complicated reverse takeover, has acquired areas in Indonesia designated as 'pulp plantations', and forest concessions for a pulp mill in South Kalimantan, the Satui pulp mill.

**The projects**

UFS has been looking to secure financing for the 600,000 tons per year greenfield pulp mill project in Satui, South Kalimantan, for years but now appears to be making progress. In July 2007, Abax Global Capital, a newly launched Hong Kong-based hedge fund announced the provision of US\$ 225 million in the form of notes and convertible bonds to this project as one of its first actions.<sup>73</sup> In February 2008, UFS also announced the signing of a turnkey contract for the pulp mill project with a subsidiary of the Chinese company China Metallurgical Group Corporation - this contract replaces an earlier turnkey contract signed in 2004 with another Chinese company, China National Machinery & Equipment Import & Export Corporation (CMEC).<sup>74</sup>

In 2004, UFS also announced the construction and operation of a 700,000 tonnes wood chip

plant on the island of Pulau Laut, off the coast of South Kalimantan. The facility has begun production in April 2007 but appears to have problems with its port among other issues.<sup>75</sup>

In addition, since 2005, UFS has repeatedly announced its intention to acquire and operate the existing pulp mill Kiani Kertas in East Kalimantan – so far unsuccessfully. Kiani Kertas was built in the late 1990s as part of the business empire of Muhammad 'Bob' Hasan, a close business associate of ex Indonesian President Suharto and, prior to his felony conviction and prison terms, one of Indonesia's most powerful "timber barons". The pulp and paper mill started operations in



**Deforestation and fire scars on a peatland forest in Central Kalimantan, Indonesia**

Photo: H.-D. Viktor Boehm

1997, by which time roughly US\$1,300 million had been invested in the project, including an export credit guarantee for machinery by the Finnish ECA. The mill was reported to be one of the most expensive mill construction projects in Indonesia with extraordinary levels of "mark up". It never operated at capacity and did not have a sufficient legal local source of timber. Company reports indicated that the mill claimed to be importing timber feedstock

<sup>73</sup> United Fiber enters \$225 million financing with Abax, AsianInvestor Magazine, 25 July 2007, Announcement, United Fiber System, Singapore, 13 July 2007

<sup>74</sup> MCC20 Appointed Turnkey Contractor For MBBM Pulp Mill, Announcement United Fiber System, Singapore, 24 February 2008

<sup>75</sup> Press release: Indonesian forestry official admits lack of raw material supply for UFS chip mill, by CAPP, WALHI Kalsel, Global2000, Environmental Defense, December 2006

from overseas.<sup>76</sup> In 2004 the mill stopped production as a result of mismanagement and inadequate fibre supplies. It is now owned by a group of investors led by Prabowo Subianto, formerly one of Suharto's son-in-laws and head of Indonesia's notoriously brutal special forces, the Kopassus. The group bought the mill with a US\$201m loan from Bank Mandiri, Indonesia's largest lender. The loan is now one of the bank's principal non-performing deals and the subject of a criminal investigation.<sup>77</sup>

UFS expressed an interest in acquiring Kiani Kertas in 2004 and claims it has secured sufficient funding for the take-over despite JP Morgan, Deutsche Bank and Merrill Lynch pulling out of the project under pressure over its environmental impact and the risk of illegal logging. It is still not clear whether UFS will succeed in its takeover bid, but whoever acquires Kiani Kertas will need to invest significantly in replacement machinery and further expansion is possible. It is likely that European ECAs will be invited to provide support for the export of machinery at this point,<sup>78</sup> despite the fact that this mill involves a significant number of "politically exposed persons" and convicted felons, thus triggering substantial anti-money laundering due diligence requirements.<sup>79</sup>

In 2006, the World Bank concluded that "forest loss and forest crime dominate the [Indonesian forestry] sector",<sup>80</sup> and that "Indonesia is losing forests at a remarkable rate, one of the fastest in the world."<sup>81</sup> It also estimated that as much as two-thirds of

Indonesia's timber production was based on illegal and undocumented sources. Its summing up stated that "industrial timber demand exceeds sustainable supply... timber plantations are insufficient and performing poorly...<sup>82</sup> [and] forest conversion – an unsustainable harvest method – has been the fastest growing source of timber supply in recent years and is a major source of supply for pulp mills."<sup>83</sup> The East Kalimantan region already faces significant over-capacity in its paper sector, with the Pulau Laut mill already running, the likelihood of a second mill acquiring secure legal supplies is minimal.

### ECA involvement

The contract to build a woodchip mill on Pulau Laut island in South Kalimantan was awarded to the Chinese company China National Machinery & Equipment Import & Export Corporation (CMEC) for a total value of US\$ 39 million. The project was financed by a supplier credit of US\$18 million from CMEC and a loan of US\$ 21 million from Raiffeisen Zentralbank Austria. Andritz has provided machinery worth US\$ 20 million.<sup>84</sup>

In 2004 a turn-key contract for the planned pulp mill in Satui, South Kalimantan was signed with CMEC for a total value of US\$863 million; an export credit guarantee from Sinosure was granted to CMEC for the insurance of the project; and pulp machinery for the mill with a value of US\$250 million will be provided by Austrian Andritz.

An application to the World Bank's Multilateral Investment Guarantee Agency (MIGA) for political risk insurance for the mill was almost successful, and other ECAs such as China Export & Credit Insurance Corporation (Sinasure) also looked into providing

76 S. Fried, Memorandum on Environmental, Social, and Financial Risks Associated with the UFS pulp and wood chip mills and the proposed UFS acquisition of the Kiani Kertas mill, Environmental Defense, November 2006. Available at: <http://pulpinc.files.wordpress.com/2007/01/ufo-ngo-letter-18-nov-06.pdf>

77 Merrill turns down UFS over Kiani funding, *Financial Times*, 22 February 2006

78 J.W. van Gelder, Data prepared for Chatham House and FERN

79 S. Fried, Memorandum on Environmental, Social, and Financial Risks Associated with Kiani Kertas, *ibid*

80 World Bank, *Sustaining Indonesia's Forests: Strategy for the World Bank, 2006 – 2009*, June 2006, p 8

81 *ibid*, p 11

82 *ibid*, p 8

83 *ibid*

84 Annual report 2004, United Fiber System, Singapore, March 2005.

insurance. According to CIFOR, informed sources at MIGA suggest that the UFS deal was very nearly guaranteed by the Agency but because of concerns over unsecured legal fibre supplies, UFS withdrew its application



**Families living downstream of pulp mill project in Indonesia**

Photo: Barabara Happe/urgewald

in March 2004. Critically, the project was not initially rejected by MIGA's internal due diligence or internal impact assessment process.<sup>85</sup> In 2006, MIGA engaged in talks with UFS again, but have now concluded that it is unlikely that they will provide any support for this project.<sup>86</sup> Regarding the question of International Finance Corporation (IFC) finance for the UFS or Kiani Kertas projects, the World Bank's Indonesia Director replied that "the IFC would have to be crazy to support this project."<sup>87</sup> OeKB, the Austrian ECA had been approached for funding after the initial MIGA defeat but appears to have rejected the project on environmental grounds.

Recently, in February 2008, the turn-key contract with CMEC was replaced by a new turn-key contract with another Chinese company, China Metallurgical Group Corporation. This construction company

has accepted the responsibility to provide a suppliers credit for the US\$ 863 million project.<sup>88</sup> This credit will probably be sourced from Bank of China, which in March 2008 agreed to provide a credit line of 55 billion yuan to finance the foreign activities of China Metallurgical Group.<sup>89</sup> But ECAs might also be approached again.

### Fibre supply and expansion plans

UFS claims that the proposed mills will source fibre entirely from sustainably-managed plantations with minimal negative impact on natural forests and communities. However, research by Finnish forestry consultancy *Jaakko Poyry*, and many independent evaluations, including by the CGIAR Center for International Forestry Research (CIFOR), have shown that it will not be possible to source the necessary quantity of pulpwood from its existing legal plantations timber sources. Their findings demonstrate that UFS has significantly overestimated the standing volume of pulpwood within existing plantation concessions, the annual rate of plantation establishment, as well as growth projections for second and third rotations at the site.<sup>90</sup> A shortfall of at least 132,916 ha of existing acacias,<sup>91</sup> and significant damage suffered to the current plantation area (through fire, illegal mining and oil palm plantations) means that the mills are expected to run out of plantation fibre within five years of operation.<sup>92</sup> In both the short and the long term, the mill will require significant additional supplies of fibre, placing direct pressure on the

85 S. Spek, *Financing Pulp Mills*, December 2005

86 Meeting with Walhi South Kalimantan, NADI, Solidaritas Perempuan, Environmental Defense, September 2006

87 *ibid*

88 MCC20 Appointed Turnkey Contractor For MBBM Pulp Mill, Announcement United Fiber System, Singapore, 24 February 2008

89 Strategic Cooperation Agreement was inked between MCC and Bank of China, Xinhua News Agency, Beijing, 12 March 2008

90 Jaakko Poyry Management Consulting, Valuation of PT Menara Hutan Buana Future Operations in South Kalimantan, Indonesia, January 2001; E. Jurgens/C. Barr/C. Cossalter, Brief on UFS, 2005; S. Fried, Memorandum on Environmental, Social, and Financial Risks Associated with Kiani Kertas, p. 12

91 Estimate by Global 2000/Friends of the Earth Austria based on calculations by JP, CIFOR and industry insiders in South Kalimantan. D. Hausknot, *Der Fall UFS*, 2005

92 E. Jurgens/C. Barr/C. Cossalter, Brief on UFS, p. 10

113,000 ha of natural forest that remains in the concession area, including 44,000 ha of mixed tropical hardwood as well as other forests in Kalimantan and elsewhere in Indonesia.<sup>93</sup>

The already significant gap between fibre demand and supply in Satui is further increased by the UFS wood chip mill on Pulau Laut that has recently begun production. Planning projections for the mill outline the intention to sell woodchips produced from some of the same plantations designated for the pulp mill in Satui.<sup>94</sup> Project documents also indicate that UFS appears to be planning to double the Satui pulp mill's capacity to process 1.2 million tonnes per year shortly after construction.<sup>95</sup> Such an expansion will not only increase the likelihood of illegal logging in surrounding natural forests but force UFS to import significant volumes of raw material from elsewhere in the region.

In light of these figures, UFS's announcement of July 2005 that it will also acquire and operate the existing pulp mill Kiani Kertas in East Kalimantan reduces the company's claims about the sustainable sourcing of its pulpwood to absurdity: now UFS will have to run two mills with already insufficient wood resources.

## Case Study IV

### Camisea – Peru

#### Unresolved land issues and the destruction of intact forests

##### The project

At a total cost of US\$1.7 billion, the first phase of the Camisea natural gas project involved the construction of gas wells, a processing plant and two parallel pipelines to the Peruvian coast. The wells are estimated to hold



**An indigenous family in Poyentimari.**

Photo: Aaron Goldzimer/Environmental Defense

around 13 trillion cubic feet of gas, with more than 480 million barrels of associated natural gas liquids (propane, butane and condensate). The project would link a collection of fields by pipelines, providing natural gas and natural gas liquids for domestic consumption and for export. The gas pipelines run 714 kilometers from the Camisea field to Lima on the coast, while the liquids pipeline runs 540 kilometers to a port south of Lima. Critically, parts of the pipelines have been sited in one of the world's most ecologically prized rainforest in the remote Lower Urubamba Valley of the Peruvian Amazon. According to the Smithsonian Institute, the biodiversity of the

<sup>93</sup> *ibid.*, p. V

<sup>94</sup> *ibid.*, p. 10

<sup>95</sup> *ibid.*, p. 15



Camisea region is unsurpassed in the world; moreover, the gas development area (Blocks 88 and 56) covers areas which are subject to legally-protected tenure rights of several groups of un-contacted indigenous peoples that have chosen to remain isolated.

The first phase project has been operational since August 2004, during which time it has been criticised for poor construction standards by a Peruvian Congressional Commission<sup>96</sup> and condemned for systemic failures to protect indigenous populations from adverse social impacts and human rights violations. Despite these concerns, plans are currently underway to expand it by developing a liquefaction plant on the Peruvian coast to convert natural gas in liquid natural gas for export for export to US and Mexican markets. The Peru LNG project, valued at US\$ 3.9 billion, is undertaken by a consortium of Hunt Oil (United States), SK Corporation (South Korea), Marubeni (Japan) and Repsol YPF (Spain). In January 2007, a US\$ 1.5 billion construction contract was awarded to the American company Chicago Bridge & Iron.<sup>97</sup> In order to supply gas to the LNG plant, the operating companies have begun to develop a new block of gas fields adjacent to the original project (known as Block 56 or Camisea II). The pipeline to transport this gas to the LNG plant is supplied by the Indian company Welspun Gujarat Stahl Rohren.<sup>98</sup>

Peru LNG's owners will provide approximately US\$ 1.5 billion for the US\$ 3.8 billion project and are seeking to raise approximately US\$ 2.3 billion of long-term loans. Significant amounts

are raised from two multilateral development banks: The Inter-American Development Bank (IDB) approved a loan of US\$ 400 million in December 2007.<sup>99</sup> And in February 2008 the International Finance Corporation, a subsidiary of the World Bank, approved a US\$ 300 million loan for Peru LNG amid intense national and international criticism.<sup>100</sup>

### ECA involvement

The original Camisea project involves two consortia of energy companies, upstream (gas production) and downstream (gas transportation). Members of the upstream consortium are Pluspetrol, Hunt Oil,



**Along this access road the entire slope had completely fallen away into the stream. No wonder the water is dirty and people report no fish!**

Photo: Peter Kostishack

SK Corporation, Tecpetrol, Sonatrach and Repsol. Downstream members are Techint, Pluspetrol, Hunt Oil, SK Corporation, Grana y Montero, Sonatrach and distribution partner Tractebel.

<sup>96</sup> Peru Congressional Commission Confirms Inadequate Pipeline Construction, Amazon Watch, June 2006. Available at: [http://www.amazonwatch.org/newsroom/view\\_news.php?id=1175](http://www.amazonwatch.org/newsroom/view_news.php?id=1175)

<sup>97</sup> International Consortium Led by Hunt Oil Company Officially Launches Peru LNG Project - Chicago Bridge & Iron is Awarded EPC Contract for Gas Liquefaction Plant, Press release Peru LNG, Lima, 22 January 2007; CB&I Awarded LNG Liquefaction Project in Peru, Press release CB&I, The Woodlands, 23 January 2007; Peru LNG moves forward, Project Finance, London, 30 January 2007

<sup>98</sup> LNG export project's plant in main construction phase - Peru, David Casallas, Business News Americas, 4 October 2007

<sup>99</sup> IDB approves US\$400 million loan for Peru LNG project, Press Release Inter-American Development Bank, Washington, 19 December 2007

<sup>100</sup> IFC Board Approves Gas Investment to Support Economic Growth in Peru Project is Largest Foreign Direct Investment in the Country's History, Press release IFC, Washington, 5 February 2008; Peru's gas exporting project gets World Bank loan, Reuters, New York, 5 February 2008

Early on in the project Chase Manhattan Bank contributed a US\$25 million loan to Pluspetrol, guaranteed by the US Ex-Im Bank.<sup>101</sup> However, in August 2003 following pressure from environmental and indigenous rights organizations, as well as members of the US Congress, the Camisea Project was denied financing of US\$213 million by Ex-Im. Just weeks later, the board of the Inter-American Development Bank, a multilateral organization with 27 member countries from the North and South America as well as the Caribbean, voted to fund the project, with the US representative abstaining.

In September 2002, the Brazilian export credit agency BNDES-Exim agreed to a loan of US\$109.7 million to the transport consortium to buy steel tubes from the Brazilian company Cofab, a subsidiary of Techint (Italy/Argentina).<sup>102</sup> Later the loan was decreased to US\$102.8 million.<sup>103</sup> In October 2005 the transport consortium decided not to take up the loan, and instead issue additional bonds with a value of US\$80 million. It is not clear why this decision was taken.

A concession to distribute gas to industries and electricity plants in the Lima region was awarded to the Calidda, which is owned by the Belgian company Suez Energy (formerly Tractebel). Suez Energy is part of the French Suez Group.<sup>104</sup> The total investment costs for the distribution part of the project were valued at US\$71 million.<sup>105</sup> The total

investment was insured by the Belgian ECA *Nationale Delcrederedienst*.<sup>106</sup>

More recently (in 2005), *Nationale Delcrederedienst* has agreed to an export credit guarantee for dredging services to be provided by Jan de Nul (Belgium) to the planned liquefaction plant on the Peruvian coast. Total investment costs for this project are estimated at US\$3.3 billion, of which 60% is being sourced from loans for which ECAs are being approached to guarantee.<sup>107</sup>

In January 2008 US-Exim, after having refused cover in 2003, approved a US\$459 million export credit for Camisea II.<sup>108</sup> It appears that Italian ECA SACE also approved a guarantee for Camisea II in December 2007 but neither the approval nor the amount could be confirmed at this point.<sup>109</sup> According to Marubeni, one of the owners of the project, the Export-Import Bank of Korea is also expected to participate in the financing of the project.<sup>110</sup>

The UK's ECGD was considering a guarantee but after pressure from civil society, ECGD confirmed in November 2007 that the company had withdrawn its application.<sup>111</sup>

### Access to forests and illegal logging

As detailed in an earlier FERN paper,<sup>112</sup> the opening of previously isolated forest brought workers, colonists and loggers to the area;

101 Activists urge banks to steer clear of Camisea gas project, Inter Press Service, Washington, 14 May 2002; N. Martinez/J. Vallette, Destabilizing Investment in the Americas: Public Funding for Fossil Fuels After Rio, Sustainable Energy and Economy Network, Washington, September 2002

102 Confab aumenta em 177,1% sua meta de exportação com apoio do BNDES-exim, Press Release BNDES, 2 September 2002; BNDES could provide US\$100mn TGP pipeline loan - Peru, Business News Americas, 29 October 2002; BNDES approves US\$109mn export financing loan for TGP - Peru, Business News Americas, 28 November 2002

103 Camisea Pipeline - Deal Of The Year Nomination Region: Latin America (Peru) Sector: Oil & Gas, Inter-American Development Bank, Washington, December 2004

104 Website Calidda ([www.calidda.com.pe](http://www.calidda.com.pe))

105 Camisea Pipeline - Deal Of The Year Nomination Region

106 Tractebel Wins 30 Years Gas Distribution Concession In Lima, Peru, Press Release Tractebel, Brussels, 3 May 2002

107 Website Nationale Delcrederedienst ([www.ondd.be](http://www.ondd.be)), Viewed in January 2006; Website Proyecto Gato ([www.proyectogato.be](http://www.proyectogato.be)), Viewed in January 2006

108 US Ex-Im Bank, Board Minutes, 24 January 2008. Available at: <http://www.exim.gov/article.cfm/0E64F560-05E1-1AB7-58FDB218D6ABF577/>

109 Confidential information from internal source at SACE, December 2007

110 Marubeni Corporation to Participate in Peru LNG Project, Press release Marubeni Corporation, Tokyo, 29 August 2007; Website Korea Eximbank ([http://www.koreaexim.go.kr/en/f/service/m01/s04\\_03.jsp](http://www.koreaexim.go.kr/en/f/service/m01/s04_03.jsp)), Viewed in March 2008.

111 Email of 26 November 2007 from ECGD to Tom Griffiths, Forest Peoples Programme

112 C. Marijnissen, Export Credits. Fuelling Illegal Logging



many of whom settled on indigenous lands. Reports of violence and illegal logging in indigenous territories increased dramatically from 2001, when construction of the project began. Local accounts reveal that Techint began work on the pipeline route and access roads illegally and without prior authorization or permission from landowners. Despite requests from local groups, the pipeline consortium has reportedly failed to provide enforcement capacity to protect the pipeline route from loggers and have left responsibility for controlling colonization in the hands of local communities, potentially placing them at the centre of future conflict over their legal right to land and forest resources. More than 80% of Camisea II or 'Block 56' is superimposed on the lands of seven titled Native Communities. At this point, questions remain over the legality of the original demarcation of Block 56 and the sale of concession rights that did not ensure meaningful prior consultation and consent of affected communities as required by international and national law.<sup>113</sup>

AIDSESP, the official representative of indigenous communities in the Peruvian Amazon; and COMARU, the Machiguenga tribal council, believe that pipeline developers have long disregarded the legal rights of local people and have endangered traditional communities and the ecosystems they depend upon. Specifically COMARU says pipeline expansion violates Machiguenga rights, the Peruvian Constitution and International Law.<sup>114</sup> In 2003, Friends of the Earth US reported that U.S. Ex-Im's Environmental Impact Assessment, obtained through a Freedom of Information Act request, provided additional evidence of illegal logging and significant social and environmental damage. The assessment found impact mitigation measures for Camisea to be 'woefully inadequate' and asserted that they would result in 'irreversible impacts' to the forest and the spread of non-indigenous

diseases. In 2005, after fifteen months of operations, the pipeline suffered its fourth significant spill as a result of failing to abide by environmental requirements and reports of illegal local damage made to date are too numerous to list.<sup>115</sup>

Although some ECAs appear to have pulled out of the project under pressure from civil society, nothing suggests that their stated environmental safeguard policies identified the weaknesses in the proposed project independently, and the support for the project by ECAs from Belgium, the US and, apparently, Italy suggest that the existing minimum international standards are not an effective screen for projects of this sort.



**An indigenous community in the Urubamba region.**

Photo: Aaron Goldzimer/Environmental Defense

<sup>113</sup> T. Griffiths: Holding the IDB and IFC to account on Camisea II, p 17 and 37

<sup>114</sup> Declaration by Indigenous Peoples in Defence of Life, Territory and the Environment, August 2003. Available at [http://www.bicusa.org/Legacy/AIDESP\\_camisea\\_statement\\_25.08.03.pdf](http://www.bicusa.org/Legacy/AIDESP_camisea_statement_25.08.03.pdf)

<sup>115</sup> Friends of the Earth US, Press Release, August 2003. Available at <http://www.foe.org/new/releases/0803camisea.html>

## Glossary

### Category A project

The OECD Recommendation on Export Credits and the Environment classifies a project as 'Category A' if it has the potential to have significant adverse environmental impacts. These impacts may affect an area broader than the sites or facilities subject to physical works. Category A, in principle, includes projects in sensitive sectors or located in or near sensitive areas.

### Common Approaches

Short for 'OECD Recommendation on Common Approaches for Officially Supported Export Credits and the Environment'. The Common Approaches aim to level the international playing field by identifying and evaluating the environmental and social impacts of ECA-backed projects.

### Contract and revenue transparency

To ensure more responsible and equitable management of extractive industries, many International Finance Institutions have started to endorse the principle of (conditional) contract and revenue transparency as set out in the Extractive Industries Transparency Initiative (EITI).

### Due diligence

A term used for a number of concepts involving either the performance of an investigation of a business or person, or the performance of an act with a certain standard of care. It can be a legal obligation, but the term will more commonly apply to voluntary investigations. In business transactions, the due diligence process varies for different types of companies. The relevant areas of concern may include the financial, legal, labour, tax, environment and commercial situation of the company.

### Emerging market economies

An emerging, or developing, market economy (EME) is defined as an economy with low-to-middle per capita income. Such countries constitute approximately 80 per cent of the global population, representing about 20 per cent of the world's economies. Although a loose definition, countries whose economies fall into this category, varying from very big to very small, are usually considered emerging because of their developments and reforms. EMEs are considered to be fast growing economies.

### Greenfield investment/project

A Greenfield Investment is the investment in a manufacturing, office, or other physical structure in an area where no previous facilities exist. The name comes from the idea of building a facility literally on a "green" field, such as farmland or a forest.

### Hardwood kraft pulp

The 'Kraft process' describes a technology for conversion of wood into wood pulp consisting of almost pure cellulose fibres. The process entails treatment of wood chips with sodium hydroxide and sodium sulfide. The name is derived from German 'kraft', meaning *strength/power* but is most commonly used in the pulp and paper industry.

### Reverse takeover

A 'reverse takeover' occurs when a publicly-traded smaller company acquires ownership of a larger company. It typically requires reorganization of capitalization of the acquiring company.

### Single pulp line

Large, single-line fiberlines have become the standard for today's new market pulp mills. Many mills started up in North America and Europe in the 1970s and 1980s utilised at least two lines, either to produce both hardwood and softwood pulp or to generate the desired capacity because a single line couldn't produce the necessary tonnage.

### Sovereign debt agreement/sovereign counter guarantee

In a sovereign debt agreement or sovereign counter guarantee the host country's government pledges payment in case of default. Hence, when the ECA-backed exporting company doesn't get paid for exported goods or services, it is reimbursed with public money that its government will try to recover from the host country through such an agreement.

### Special Drawing Rights (SDRs)

SDR is an international reserve asset, created by the International Monetary Fund (IMF) in 1969 to supplement existing official reserves of member countries. Today, the SDR has only limited use as a reserve asset, and its main function is to serve as the unit of account of the IMF and some other international organizations.

### Turnkey contract

'Turnkey' refers to something that is ready for immediate use, generally used in the sale or supply of goods or services. The term is common in the construction industry, for instance, in which it refers to the bundling of materials and labour by sub-contractors. A turnkey project is a project in which separate entities are responsible for setting up a plant or equipment and for putting it into operation.

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FERN works to achieve greater environmental and social justice, focusing on forests and forest peoples' rights in the policies and practices of the European Union.

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